

OUR "REVOLUTION" IN INCOME DISTRIBUTION

An Appraisal

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IT IS the enthusiastic custom of economists to label as revolutionary and permanent any important change in our mode of economic organization which endures for as long as five years. In the 20's, after the First World War, it was the vain-glorious boast of American economists that permanent prosperity had been achieved. When the horrifying events of 1929 ended this dream (the story is told with wit and urbanity by J. K. Galbraith in his recent book *The Great Crash*), they adeptly substituted the notion of permanent depression and proved that forevermore American capitalism would face diminished incentives to investment, and could expect therefore only unemployed men and machines, and static or declining living standards. This theory of economic maturity no sooner achieved sophisticated form than the Second World War and the inflation following it persuaded numerous observers, among them the astute London *Economist*, that the Age of Inflation was upon us, that we could anticipate steadily rising prices, wages, and incomes without limit. For the last two years American prices have perversely remained firm or even sagged. So it has gone. We have had

HAVE we achieved an "economic revolution" in income distribution in the United States? Many of our foremost economists believe we have. But there are dissenting voices, pointing out that for all the tremendous gains already made, we have a good way to go before we can declare this economic revolution complete and secure. One cautionary note is here sounded by ROBERT LEKACHMAN, an associate professor in the economics department of Barnard College. Mr. Lekachman was born in 1920, and educated at Columbia University. His last appearance in these pages was in our September 1954 number, with "Economics: Science or Visionary Art?"

managerial revolutions, organizational revolutions, and in the earlier writings of Galbraith a new concept of power relationships, the now fashionable cliché of countervailing power.

The latest of these revolutions to be proclaimed is in the field of income distribution, and the evidence for it is founded upon a much solidier basis of statistical investigation than usual. Briefly, this view claims that in the last fifteen years income in the United States has been more and more broadly distributed, and that this trend promises to continue into the future. However, if we evaluate the accuracy of the claims made and examine their implications, we shall find that the story is not so simple, though real changes in income distribution have indeed occurred and their results are substantial. We shall find that these gains are possibly transitory, and the revision of perspectives they suggest not altogether warranted.

A VAGUE discomfort overcomes many Americans at the spectacle of great or at least obvious differences in income, a discomfort probably associated with our deep-seated assumption that one man is (or should be) as good as another, and that luck or greed rather than ability decides the distribution of economic rewards. This discomfort must have diminished in the face of recent evidence of income redistribution. A comparison may illuminate the change. In the inter-war period, 1919-38, the top one per cent of income recipients collected on the average 15 per cent of the total national income, and the upper 5 per cent got 30 per cent of all income. By 1948, the upper one per cent were receiving only 8.5 per cent and the top 5 per cent only 18 per cent of all income. In ten years we had moved half the way to income

equality. Moreover, these last figures represented a diminishing share of an increasing pie. Economic expansion had enabled lower-income groups to improve their lot absolutely as well as relatively, and softened the shock of relative loss by the upper classes with the consolation of undiminished real income. This shift is all the more astounding when we note how stable the proportions of the total income received by the various income groups were between 1919-38 and how little affected by business cycles or other major events. There is certainly no parallel in our economic history, or indeed in the economic history of any other land, for a change on the scale experienced since 1938 in so short a time.

How can we explain the statistical facts? Of the reasons for our drift toward greater income equality, the most obvious is the decline in unemployment from something like 9.5 million in 1939 to 0.7 million in 1944. Or to put the matter more affirmatively, one cause of declining inequality has been rapid economic growth. Since the upper-income brackets earn by far the lion's share of income from property and the rest of us depend much more largely on wages and salaries—the "employee compensation" of the statistics—anything which increases employment increases, other things being equal, both the share of employee compensation in total income payments and the share of the lower 95 per cent of the receivers of income. And with the decline in unemployment, greatly increased overtime became available, which further increased the shares of the gainfully employed.

A principal consequence, then, of the decline in unemployment has been to decrease the share of income derived from the ownership of land, securities, and other assets, and to increase the proportion of income derived from work or personal services. Today the fact that property owners can still buy advantages for their children and themselves in the form of better education, wider social connections, and great opportunities in jobs and professions—in the arts and graces of life—does not seem to imply neces-

sarily, as it did before, the consolidation of inequality or its increase in the future. There can be a happy cycle of more education, more opportunities, more education, and more income for more people, as well as a vicious cycle of low income, scant education, and still lower income for more people.

Like the unemployed, farmers before 1939 had lagged behind the income procession. But after 1939, farm income increased a good deal more rapidly than did other forms of income. Although farmers even now earn less on the average than does the non-agricultural sector of the population, the difference has diminished.

Even within groups, there has been a noticeable tendency for the lower paid to advance more rapidly than the higher paid. Wages were higher in the past in finance, transportation, and communication than in manufacturing. But between 1939 and 1948 wages rose more rapidly in manufacturing than they did in the other three fields. At the same time the importance of the low-paid services trades has shrunk. A case in point has been the decline of domestic service, a traditionally ill-paid and ill-regarded occupation. Furthermore, the wage policies pursued by trade unions have tended to diminish the differentials between skilled and unskilled labor. The practice of the big CIO unions in particular has been to press for flat-amount increases (ten cents, twenty-five cents, etc.) rather than for percentage increases. As simple arithmetic demonstrates, a succession of these flat-rate increases for everyone has the effect of diminishing the percentage differentials that separate the various groups. Finally, the relatively harsher impact of the progressive income tax on the upper-income groups has also operated to narrow income differentials. In fact, wherever we look we find that the humble have improved their income status and, miracle of miracles, no one is the worse off, since there is so much more for all.

Moreover, some portion of the income inequality which still persists is wholesome. As is sometimes overlooked in discussions of income distribution, income increases with age

right up to the few years which precede retirement. Here is a built-in element of inequality that, upon reflection, few individuals would care to eliminate. For should not a man as he grows older reap the fruits of increasing professional capacity, should he not expect a better standard of living to accompany broadening tastes and growing family responsibilities? In fact, our society would be guilty of injustice if it rewarded equally the interne fresh from medical school and the mature specialist of fifty, the law clerk and the veteran trial lawyer, or the new college instructor and his distinguished seniors.

All of these changes have taken place in an expanding economy accompanied, as one would expect, by rising birth rates, new construction, and increasing economic totals of all varieties. It is not too much to say that without a leveling up of income distribution these could not have eventuated as rapidly as they have, and very possibly not at all.

SO MUCH for the facts of our income revolution. What do these statistics imply about the quality of American life, the range of opportunities now available to Americans, the standard of living within the grasp of most citizens?

There is no doubt, first of all, that the good things made possible by American technology—automobiles and refrigerators, Paris copies and homburgs, Grand Rapids furniture and inexpensive reproductions of great art—are more widely distributed than ever before and little doubt that this is a happy change. Of course, substantial quantities of these goods are bought on some kind of credit. But consumer credit is itself an invention worthy of democracy, combining as it does faith in the average man's honesty and confidence in his earning powers.

It is true that not all automobiles are Cadillacs, and reproductions are not originals. But it is also true that Chevrolets look a good deal more like this year's Cadillac than like the Chevrolet of ten years past. It is probably accurate to add that, in general, the clothes, durable consumer goods, and

even the houses designed for most of us, look surprisingly like the more expensive originals from which they are copied. Moreover, to a degree success feeds upon itself: as the market widens, unit costs decline and external economies become available to more enterprises; thus the celebrated advantages of mass production achieve wider scope. There is simply no question but that for more and more Americans the world is full of desirable material objects that fall increasingly within their grasp.

We needn't deprecate the advantages of possessing physical objects. All the world, including the supposedly ascetic Orient, envies the combination of luck and cunning joined in the American achievement of material plenty. But something more important than mere command of commodities flows from the greater equality of incomes we have been describing. More Americans than ever before have learned discretion in the spending of their incomes. No longer is life a daily struggle between inflexible income and frustrated demands for the bare physical elements of subsistence. Much of what Americans now buy ministers to their comfort and even their luxury, rather than merely satisfying their minimal needs. The durable consumer goods that are the indices of our living standards have long lives. The dates of their purchase are therefore optional. As Americans learned somewhat to their surprise during the Second World War, automobiles can run as long as fifteen years, and old refrigerators and vacuum cleaners can be made by judicious repair to yield faithful service indefinitely.

THE consumer chooses not only among various occasions for purchase but also among many possible items and, though a great deal of advertising touts spurious differences among goods, genuine variety does exist and the keen competition of many sellers for a rich harvest of dollars has made product differentiation profitable for many manufacturers and sellers. If true freedom involves real choice, then in the economic sphere Americans possess more freedom than

ever before: to buy goods, to postpone purchases, to alter their decisions, even not to spend their money. Businessmen ever alert to changing markets have noted these facts. Advertisers make special appeals to Negroes, which is a sign of the increasing prosperity of this traditionally oppressed group, since a group not free to choose is not economically worth the expense of appealing to. Such is the arithmetic of business enterprise. Publishers of "true confession" magazines have appealed to national advertisers to note that their readers—mostly wives of wage-earners—now represent a market with great spending power and, the inevitable concomitant, considerable discretion in its use. The true democracy of commerce is spending ability. By this criterion, democracy is advancing rapidly.

But has the American consumer done anything more with his new-found discretion than to tread a cautious path among rival television sets and competing refrigerators? Fortunately, the evidence is overwhelming that much better use is being made of the new economic freedoms than heretofore.

Millions of Americans have altered their lives in a most fundamental manner: they have left the city and moved to the suburbs, and in so doing have made many changes in the social landscape—some of them already well described in the pages of this magazine. Above all, this movement has been coupled with home-ownership. For the first time in the 20th century more Americans own their own homes than live in rented premises—even if they share their ownership with the bank that grants the mortgage. Most of the new homes are small, many of them have been hastily erected and remain depressing in their similarity to the dozens which surround them: nonetheless, numerous citizens can open their own doors and enter their own homes.

The new suburbia has fostered no intellectual renaissance. It is certainly too soon and the evidence is too slight to conclude that the new leisure has quickened the intellectual hunger, improved the taste, or deepened the values of any substantial num-

ber. The highest of the new values seems to be job security, income, and social status and acceptance. But the move to the suburbs is recent; in the past, cultural efflorescence has always depended upon, if it has not paralleled, a material margin above bare existence. Our margin is greater in amount and wider in distribution, and therefore suggests at least the possibility of cultural advance, of improvement in the quality of life as well as in its sheerly material comfort.

THE picture so far painted is on balance a cheerful one. More people have more things in our land than ever before. But it is not altogether as simple as that.

There are technical considerations that lessen the conclusiveness of the income redistribution statistics. National income definitions exclude from the statistical totals two kinds of real income which, when taken into consideration, swell the share of upper-income groups: expense accounts and capital gains. There is no question but that expense-account allowances are an important element in the income of the better paid, or at least that they exceed the purposes for which they are ostensibly granted. The expense account forms in effect a kind of uncounted and untaxed income. Because national income endeavors to isolate the return from productive labor from other forms of dollar income, capital gains are also excluded from the total. No increased quantity of products corresponds to a capital gain, and increased product is the computer's test of productive activity. Although the average man may on occasion sell a house or some securities at a price higher than what he paid and thus realize a capital gain, it is the top one and 5 per cent of the income recipients who benefit most from this kind of gain, and there is every incentive from the tax system, which bears much more lightly on income from capital gains than it does on income from work, to convert as much income as possible into capital gains by whatever legal device appears legitimate. In general, it remains true that the larger the income the greater the possibility of per-

fectly legal tax avoidance. At any rate, the profits garnered from stock market speculation and real estate transfers escape the net of the national income analyst.

Somewhat more ambiguous is the case of undistributed corporate profits, which are not included at the present time in these income comparisons. If these sums were taken into account, they would be found to go mostly to those already receiving the larger incomes. Since the amounts involved are considerable, such an accounting would show a substantially greater inequality of income distribution.

Finally, most national income measurements tend to overestimate the trend towards greater equality because of the shift of much home production to the factory and the market: when the housewife does her own baking and laundry, the value of her product goes unmeasured, but when commercial bakeries and laundries, not to mention supermarkets and restaurants, assume her functions, the apparent value of output rises, for each of these commercial services has a price tag attached to it and the national-income computer, in summing these price tags, registers an increase in output which has not actually occurred. There is no doubt that more and more of food-processing, to cite just one item, has been transferred from home to factory. The housewife need not even cook her sausages; she can buy them in a form which requires only warming and browning. Her meat is cut and packaged for her, her vegetables cleaned and canned or frozen, her soups prepared in "homelike" factories. Our figures, in other words, overstate the improvement in our standard of life as measured by the quantity of material goods, although they may understate it if we try to set a value on leisure as an unmeasured product whose quantity has grown by virtue of this increased division of labor.

THESE technical qualifications as to income redistribution add up to an unknown total; but they are qualifications only, affecting the magnitude and not the direction of the shift toward greater income

equality. What is much more troubling for a democratic society is some of the ways in which we still deprive groups of people of equal access to the fruits of our increased productivity and total wealth.

Although we may recognize at the outset that a world in which economic equality were to be complete (dodging the difficulties of definition here involved) would be a world insufferably dull and perhaps inconsistent with natural human cravings for individuality, it remains true that the only inequalities that a democratic society can with self-respect recognize are at least roughly correlated with inequalities of ability and energy. But it is a self-evident fact that we do not grant all of our citizens equal access to markets on this basis. It is nowhere possible for a Negro to acquire land or housing on the same terms and in the same places as a white person. Because this is true, rents paid by Negroes are much higher, their living conditions much worse, and their real income, therefore, much lower than those of white persons of similar ability and apparent money income. The Negro slums of New York, Chicago, and other Northern cities are a grim reminder of what the absence of equal access to markets entails. We accentuate the inequalities which already exist between the incomes of whites and Negroes.

Then we compound this injustice by our refusal to allow Negroes and some other groups, too, equal chances either for education or employment. Negroes, Jews, and Italians can become doctors much less readily than can Anglo-Saxons, and this barrier is made higher by the tendency of medical and other schools to grant preference to relatives of their alumni. If they succeed in attaining an education in the face of these odds, Negroes in particular find only narrow scope for the employment of their skills, and Jews and other minorities encounter barriers in the way of their attainment of those managerial positions in the great corporations which more and more represent opportunity in the business world. The inevitable frustration they feel is an unattractive comment on our "use" of human beings.

There is much justice in the common view that we have done a great deal in recent years to lower these barricades. Segregation has suffered possibly fatal blows, restrictive covenants have been shattered, anti-discrimination legislation has been passed. The trend is favorable: it is no longer fair, if it ever was, to label the entire South an unprogressive, reactionary area; and Northern attitudes have also improved. What is still true, however, is that *these gains are extremely precarious, for they have occurred very largely during a period of economic advance almost unprecedented in our history.*

We are thus brought to our central reservation about the meaning of recent decreases in income inequality—their possible impermanence. All of these mitigations of income inequality have accompanied high prosperity and rapid economic growth, and prosperity has promoted as well as paralleled economic equality. Prosperity means more employment and weakened employer resistance to wage demands and shorter working hours, at the same time that it increases overtime opportunities. During the recent economic recession, more workers lost income because of the disappearance of overtime or even full time, than actually lost jobs. In a year like 1954 we would have done well to maintain gains in income equality already registered. It is much more likely that we went backward. But as our overwhelmingly Republican press emphasized long past the point of boredom, this was only a mild recession, harmful to few. What will a real departure from full employment mean? How many workers will lose their jobs? How many more will see their incomes diminish?

Still more precarious is the position of the farmer. His income mounted during and after the war partly because food needs increased to a new point, partly because a complex apparatus of government supports maintained prices, and partly because high levels of consumer income within the United States promoted consumption of increasing quantities of meat, vegetables, and dairy products. In the last few years each one of these props to farm prosperity has been weak-

ened. Other nations have increased their agricultural production at the same time as marketing difficulties have impeded the free flow of food from the United States to the remaining deficit areas. Economic recession within the United States, however mild, has slowed the rise in the quality of diet. The farm policy of the Eisenhower administration, whatever can be said in its favor on general economic grounds, has supported farm income less strongly and has probably penalized the less prosperous farmers most.* All of this has happened, let it be emphasized, during a period when demand by most criteria has been very high and when unsettled world conditions and large military establishments have alike promoted farm production. No very difficult feat of inference is needed to picture the drop in farm income which less favorable combinations of circumstances might cause.

A special feature of the recent recession operated to increase the proportion of income derived from property and to diminish that derived from work: the repeal of the excess-profits tax. It is this legislative act which explains the elementary paradox that greeted the reader of corporate reports when time after time he encountered the headline "Net Profits Up, Sales Down." National income declines reflected themselves in loss of sales and labor income. Profits remained high and the distribution of income moved away from that degree of equality already achieved, since property income still remains highly concentrated among the top percentiles of the population. This effect was reinforced by stiffening employer resistance to higher wages and to the fringe demands which recent labor negotiations have featured.

SO FAR, in a sense, we have been examining no more than the surface of the problem. During these years of economic good fortune, numerous Americans have

*Like most other economists, I support out of economic principle Secretary Benson's efforts to make the farm market more free. Like some other economists, I think he timed his program badly.

given hostages to continued fair weather. They have embodied their income increases in durable consumer goods. More than this, with the willing aid of banks, automobile dealers, finance agencies, department stores, and small loan companies, they have pledged future income and, in many instances, increases in future income against immediate possession of automobiles, refrigerators, television sets, and, above all, houses. No major depression is required to cause trouble for the optimists who have been encouraged to buy beyond their means by all the lures and wiles at the disposal of modern American merchandising. The new suburbs covering yesterday's potato fields are communities of debtors whose titles to their possessions are conditional and contingent upon increased earnings.* Like Alice, they must run just as fast as they can in order to stay just where they are, and faster still if they are to improve their lot. We can only guess at the tensions and anxieties generated by this relentless pursuit of the emblems of success in our society, and shudder at what they might give rise to during an economic setback. At any rate, the ownership of these new assets is even more precarious than recent increases in income and recent changes in its distribution. Although waves of repossession have yet to lap over the heads of these struggling home- and automobile-owners, no inherent law of American good fortune guarantees us against the major depression that could bring this about.

THE scale upon which our corporate economy is constructed further complicates the prospects of the home-owner and further contributes to his instability. The centers of decision in our economy have steadily shrunk in number as the size of the corporate giant has steadily increased in response to the growing advantages—technical, financial,

advertising, research, sales—of hugeness. General Motors, General Electric, Swift, Armour, Ford, United States Steel, and their peers each numbers its employees in the tens, if not hundreds, of thousands. Scores of their plants cover the country. Corporate decision may with complete propriety close or shift a given plant and, as a matter of routine, transfer employees from one place to another. What of the worker or junior managerial employee who has sunk his roots in the community where he works? Granted that property ownership carries with it spiritual rewards, can the same be said of peripatetic property ownership? An engineering friend once suggested that large companies should have homes and families on tap all over the country so that when an employee was transferred the laborious task of shifting his family and possessions could be avoided. He would simply move into a new home in a new city, filled with standardized furniture, and a customized, company-approved wife and children. His former family would wait with equanimity for their equally mass-produced new head to come from his city of prior employment. It has not yet come to that in American industry, but increasing numbers of Americans, many of them quite low in the income scale, lead the lives of nomads. It is fortunate that their camels have carburetors.

Sometimes the unit affected is as large as a whole community. When General Motors and Ford lock in deadly embrace over the division of the automobile market, not the least of the casualties is the town of South Bend, Indiana, where the Studebaker works are located. The effect of the corporate decision is widespread and often decisive to the economic health of both communities and individuals. The responsibility of heads of corporate entities is to their stockholders; they owe no allegiance to the wider public—any consideration they extend to it is an act of grace, not a matter of right. Corporations may act in the public good but, again, they may not. It is a long time since economists as a group believed that the calculus of private profit infallibly converged with the

*Many home-owners who are veterans have made no cash down payment at all on their houses. Some veterans and non-veterans, too, have had their closing fees included in their mortgage. In the latter instance perhaps two years must elapse before the "owner" acquires *any* equity in "his" house.

public interest. The increased power of the corporate manager is no matter of individual malevolence or benevolence. The scope of managerial decision has inevitably broadened as the size of business unit has increased.

IN POINTING to the essential instability of the movement toward income equality, have we overstated the case? After all, have we not since the dark days of the early 1930's so improved the institutional arrangements which guard prosperity that a major depression need never again occur? Have not our corporations learned to reckon with the power of trade unions, other corporate giants, and government? Does not the sum of these changes imply that the powerful trend toward increasing equality of income fostered by prosperity and economic growth will never be more than temporarily reversed?

In answering these questions, unqualified pessimism is as mistaken as unqualified optimism. The list of groups protected against economic adversity is long and the measures designed to prevent a severe depression are numerous. Manual workers enjoy the benefits of Fair Labor Standards legislation that is occasionally strengthened, as in New York, by state laws. Their unions, aided by the Wagner Act, have been hampered only moderately by the Taft-Hartley Act. A network of social measures, federal and state, regulates workmen's compensation and conditions of employment. An impressive collection of union welfare funds and company pension programs guards the worker against indigence in old age. Directly or indirectly, these features of the economic landscape are brakes against drops in income. They are supported by agricultural legislation which still protects most farmers. Pressure to increase the scope and amount of such legislation would rise during a depression and probably have effect. Credit avenues open to farmers are wider and more numerous, and terms much less onerous, than ever before.

Nor is this all. An armory of powerful

fiscal weapons can and probably will be employed even by a conservative administration. Government deficits are produced automatically under adverse economic circumstances by the action of the progressive income tax, which is very sensitive to even moderate dips in income payments to individuals and corporations, the amount of the deficit representing a net addition to spending potential. The Federal Reserve System can enlarge the supply of currency and credit available to the business community by its traditional weapons of open-market purchases of government securities, and variations in rediscount rates and reserve requirements. Tax reductions can encourage consumer and business spending. A final resort to public works is always possible. The huge program of highway construction proposed by President Eisenhower is an illustration of one kind of program. Our schools could usefully absorb enormous sums of money in plant expansion and replacement. By these and other techniques, an alert administration can protect groups most directly threatened, and act more widely against general economic reversal. Perhaps as important as any one of these measures, or even all of them combined, is the general public confidence that never again will a federal government stand by passively and watch its constituents suffer.

We cannot doubt, therefore, that we are better off now than we used to be because these safeguards have been built into our economic system. But one overwhelming fact argues against complacency: *not one of these measures has yet been tested in action by a severe economic reversal.* Recent economic history tells the story. All of these measures date from the first two administrations of Franklin Roosevelt. Now the plain fact is that recovery from the doldrums of the 1930's was incomplete right up to the beginning of the Second World War, despite spending on public works, financial encouragement, inflationary policies, and protective farm and labor enactments. Since 1939, war, postwar boom, another war, and preparations for a third have dominated the economic

scene. Without denying that population growth and technological advance have also been powerful factors, the conclusion is inescapable that we do not know how successfully we could combat the threat of a major depression.

Neither have we logically disproved the gloomy hypothesis of "secular stagnation"—the fashionable notion of the 1930's that the forces of expansion have been diminishing since the First World War and that chronic deficiencies in demand and employment are to be anticipated. It is still possible, as the "secular stagnationists" maintained, that 1914 was some sort of dividing line between the America in which free enterprise moved from triumph to triumph and an America in which free enterprise requires more governmental supplement and continuous public intervention than most Americans favor.

Under the circumstances, elementary caution compels us to view prosperity itself as a precarious achievement and the gains derived from it as uncertain. The whole record of economic advance is a warning, for it is a tale of continued instability in every industrialized land. Paradoxically, the very success of our economy has tended to increase the danger of instability. For the mark of the rich economy is its ability to postpone

expenditure. Consumers can wait for their durable goods. Businessmen can postpone projected expenditures on equipment, and delay the construction of new factories, should they take alarm at the immediate economic prospect. We can wait because we are rich. The problem of poor countries is starvation. The problem of rich countries is the business cycle.

We must guard against the fashionable error of assuming that the economic future will resemble the economic present. Especially, must we be cautious in predicting a continuance of the economic growth which has had so much to do with our gains in equity. It is a sobering fact to a social scientist that the record of economic prediction is extraordinarily poor, so poor indeed as to suggest that we understand very little of the intricate social and economic processes which shape our lives. We know much less about the causes of prosperity than the optimists among us think, and still less about how to control economic fluctuations. Therefore we must be wary of regarding the so-called revolution in income distribution as anything more than a temporary improvement that can become permanent only at the price of vigorous private action and imaginative public policy.